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Companies Law in Indonesia

Paul H. Brietzke*
March 2000

My article aims at a moving target: law reforms concerning some of the business organizations in Indonesia. A few reforms have been drafted, more are being discussed, and still more merit attention, as efforts to help realize Indonesia's immense economic potential over time. This article is both too early—before the lines of reform become clear (or not) under a democratically elected Government—and too late: many resources have been wasted, while inappropriate things were done through inappropriate institutions. Nonetheless, now is the time to at least think about what *can* be done.

Indonesian business enterprises can be placed on a continuum, which is defined by transaction cost considerations that (in turn) depend on the nature and extent of a separation of ownership from control in a particular enterprise: *infra.* The greater this separation, the greater the problems of enterprise governance. These are differences of degree rather than of kind, however, especially since businesspeople can 'customize' their enterprises by contractual means (in narrowly limited ways in Indonesia, alas), and can change them later or choose other enterprise forms as business needs change. Ideally, a developmental 'Long March' ensues, through enterprises of different types and a growing wealth, size, and thus complexity.

It thus makes little sense to treat these forms in isolation from each other, especially as businesspeople see most legal boundaries as artificial: proprietorships, styled as 'informal' entities by economists (often technically illegal, and thus vulnerable to police and bureaucrats' demands for bribes); several varieties of partnership; ordinary companies; and companies which sell shares in a capital market, but which often remain controlled (closely-held) by a few shareholders. (*See* Pangestu, 2000; Tabalujan, 1996, 883.) These enterprises may have domestic investors, foreign (perhaps multinational) investors, and/or the State as an investor. State-owned enterprises (SOEs) may be run under the Companies Law or under administrative laws (typically verging on a law-lessness) of their own, and the privatization of SOEs blurs enterprise distinctions—as does the (Draft) Corporate Governance Code.

A 'competitive neutrality' must be created among these forms (Pangestu, 2000), a non-discrimination or the 'level playing field' that is sometimes twisted during Indonesian political battles. Issues in competition law and in debt finance (banking law, secured transactions, bankruptcy, IBRA, the Jakarta Initiative, etc.) are mostly excluded from this article because they are dealt with adequately elsewhere (e.g., Brietzke, 2000 and sources cited therein), and because

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they would make already complex analyses even more complex. To keep this article within manageable bounds, only Companies Law and the Corporate Governance Code will be discussed. Future progress in other areas may warrant a second installment. Readers who are bored by theoretical overviews can skip the next section, and pass on to the details of the argument.

'Jurisprudence' (n.1)

The notion of a 'paradigm' has been thoroughly deconstructed in law and philosophy, so imagine a law reform 'field' (as in a social science 'field theory') that looks like this:

Constraints of the past (including colonialism)

Incentives **Organizations**

Specific Cultures

What this simple diagram says is that everything is interrelated: law reform involves getting the incentives and organizations right, after taking account of constraints (*infra)* and specific cultures. Business incentives should be to make enterprise-favoring decisions quickly, to take calculated risks accordingly, to enable each participant's protection of her own interests—without the excessive veto powers that lead to organizational gridlock, to build a valuable enterprise reputation for honesty and fair dealing, and to obey the law creatively and to otherwise escape the attentions of (possibly corrupt and incompetent) bureaucrats and judges. (Black & Kraakman, 1996, 1914-16, 1940, 1997-98.) The relevant cultures are those of businesspeople from different countries, regions, ethnic groups, and/or religions; and of the politicians, bureaucrats, police, lawyers, accountants, and others who interact with businesspeople.

These cultures, and thus preferences in business and in law, will differ significantly among, for example, an IMF bureaucrat (an 'internationalist', who may nonetheless retain an ethnocentric approach to law and business), an Indonesian politician with economic nationalist leanings, a Muslim Batak businessperson, and a certain type of Indonesian lawyer--whose fondness for an archaic Dutch law is reinforced by the rent-seeking opportunities its arcane provisos offer. The same law reform will not suit all of these people, so choices must be made about which culture(s) to favor, and how. If the choice turns on who will pay the most for the reform, the initial 'winner' will be the IMF bureaucrat—who commands the 'loans' that the regime needs to survive. But it will turn out that this reform cannot be 'implemented' once the 'loans' are dispersed, because it is does not serve the needs and desires of other, more relevant 'players.'

A field theory also shows why successful law reform is much more complex than the simple diagram above suggests. The elements in this diagram are frequently hidden by the thick, almost-primordial soup (the field) that the diagram swims in. Some of the ingredients of this ever-changing soup can be guessed at: the interplay of a general culture and various ideologies, which often encourages opportunistic behavior and discourages certain profit-making activities; perceived business conditions and opportunities (in markets that are frequently fragile or fragmented), which sometimes or often prompt a disobedience toward formal legal rules; the corruption that flows from this disobedience and that leads to the selective non-enforcement of laws; and the political will to reform (or not) that is a compound of leadership qualities and of how these qualities relate to the rest of the soup.

In other words, it is *relatively* easy to reform a law, and nearly impossible to then implement it effectively--to get through the soup. The constraints in the diagram above are thus perpetuated: with few exceptions, enterprise law consists of the *under-categorized and over-determined rules* characteristic of a traditional and intensely-regulated civil law system like Indonesia's. (n.2) Because legal change has lagged far behind economic change over time, the categories of status permitted by Indonesian law are insufficiently rich to facilitate the many niche activities that characterize a complex modern economy (under-categorization).

Given another Dutch/Indonesian desire that is the source of much bureaucratic power and many bribe-opportunities—the passion to regulate everything in detail--relatively little customizing of enterprises or transactions is permitted, by contracts among the relevant parties. (Such over-determination verges on the old joke about governance in a Prussian *Polizeistaat*: everything not forbidden is mandatory.) Without more legal categories that pay more attention to Indonesian contexts, the de-regulation popular among market liberals will have only modest effects on incentives, organizations, and a genuine freedom of choice. A greater number of side effects that tend to favor elites will also be evident. For example and according to Pangestu (2000), the Indonesian *Crismon* (the Economic Crisis that began in 1998) was largely caused by a deregulation ad hoc: liberalization of the financial sector without accompanying improvements in supervision, and without a liberalization of the 'real' sector that proceeded to misuse bank loans. (The latter liberalization is the goal of enterprise law reforms, of course.)

A major reason for Indonesian constraints and their resistance to reform is the insufficient attention paid to the economics of Indonesian business, now as well as in the past. I once criticized a draft of what is now the Fiduciary Transfer Registration Law (n.3) because it failed to reduce creditor risks and transaction costs as much as is possible under 'international-standard' legal regimes. Indonesian debtors will thus pay higher interest rates and have access to fewer loans, I argued, in textbook economics fashion. "So what: if banks don't want to lend money in Indonesia, they don't have to", came the response from an influential leader of the Law's Drafting Team—a talented and sensitive Indonesian lawyer in the Dutch tradition. This kind of approach to law and its possibilities is a prime (initial) constraint on reform.

As is fashionable, I will draw some analogies between good (public-sector) governance and enterprise (private-sector) governance. These come together in a good citizenship, in the checks and balances running from a stronger civil society to government (Muhammed, 2000), and in the 'freedom of enterprise' essential to a citizen's democratic autonomy: doing it yourself, rather than waiting for a paternalistic state to (perhaps) do it for you. But a Robinson Crusoe clearly has no need of good governance: a transparent, accountable, and participatory parliament, bureaucracy, and judiciary. Similarly, a *kaki lima* owner (vendor from a pushcart) in Jakarta, who supplies all of her own labor and capital, has little need of an enterprise governance.

While it has never lacked for critics, the Berle and Means (1932) thesis tells us why this is so: it is the separation of ownership and control that makes the rules of enterprise (as well as public-sector) governance necessary. (Just like a citizen in a democracy, who votes or--except in Australia—abstains from doing so, a 'minority' shareholder owns the enterprise in theory but rarely controls it in practice.) Our *kaki lima* owner experiences no such separation; she easily holds herself accountable because she experiences none of the 'agency problems' that preoccupy economists as well as lawyers. If she decides not to work—to implement the economists' 'leisure preference' that constitutes a 'shirking' by employees or managers in more complex enterprises—she immediately feels the consequence of a reduced income. Unlike managers or controlling shareholders in more complex enterprises, she cannot engage in 'rent-seeking behavior': any rents come as direct deductions from her income. But she likely experiences some or many deductions from income because she has to pay off rent-seekers who operate from outside of her enterprise: the police, bureaucratic licensers, etc. If she sells *kreteks* (clove cigarettes) and the manufacturers have enough market power to keep the price at higher than competitive levels, she will have to pay rents to these manufacturers as well. (A 'rent' is that part of a reward paid to a 'resource' which exceeds the value of its *economic* productivity: a bribe paid to a politician, which reflects his perceived *political* productivity, for example.)

Why, then, does a separation of ownership and control occur, exposing the owner(s) to a costly shirking and rent-seeking behavior? Because owners seek higher profits through an expanded scale of operations, in a necessarily more complex enterprise with additional employees, sources of capital, etc. The more complex the enterprise, the higher the transaction (or information) costs (n.4) of curbing behavior which is pathological from the owners'/enterprise's standpoint. The means of reducing these costs, and thus promoting efficiency by reducing shirking and rent-seeking, are to be found in sensible rules of an enterprise governance, as well as in sensible enterprise designs: typically, the (costly) hierarchies that exist to monitor and sanction the behavior of would-be shirkers and rent-seekers. Such designs in turn give rise to two other problems, which enterprise laws should also deal with creatively: flow-of-information problems within and around the enterprise, discussed later and in the previous footnote, and the issue first raised by lawyers in ancient Rome—'Who monitors the monitors?' (n.5)

Companies: Basic Themes

Will this kind of economics learning make any headway among the various specific cultures sketched earlier? (While effective enterprise laws are context-specific, *see supra*, ways of increasing the value of various enterprises in economics terms are near-universal: *see* Black & Kraakman, 1996, 1913-14.) Some or much resistance to this learning can be seen as well as predicted among Indonesian officials and professionals: among other things, economics learning counsels reductions in their power and rent-seeking opportunities. But the businesspeople themselves should be (and seemingly are) motivated to adopt this learning: they want to reduce their costs and thus increase their profits. Economics suggests that something largely under business people's control, incentive and enterprise design and re-design, is at least as important to a profitability as is the formal law that channels and constrains such designs.

The Companies Law (No. 1 of 1995) is the best example of the limited influence economics learning has exerted over Indonesian enterprises to date. In the argot of the companies law professors, this Law is 'enabling'—modestly advancing a freedom of enterprise in several respects—while perpetuating many 'mandatory' features, especially through its accompanying regulations and its failure to use many 'default rules' that can be customized (contracted around) by the participants. (n.6)

A Drafting Team is now considering Revisions to the Companies Law. (n. 7) These Revisions are driven in large measure by the IMF desire for Companies Law and Registry reforms: although the IMF's January 2000 Letter of Intent is silent on this subject—if on few other matters—the May 2000 LOI promises such reforms by May 2001. (n. 8) This is in sharp contrast to the short time horizons set for other Indonesian legal reforms, and we hope for thorough and balanced final Revisions: like the rest of enterprise law, different rules of the Companies Law matter a great deal at different stages of an enterprise's life-cycle (Bergloff and von Thadden, 1999). Several problems attend the very birth of an Indonesian company. Rather than a simple and cheap notice-filing of this birth, based on a short check-list of elements to include in the filing, formalistic notary deeds—which foster a rent-seeking behavior by Indonesian notaries--are registered only after the explicit approval of the Ministry of Law and Legislation (MOLL). A virtually unlimited MOLL discretion reportedly leads to more rent-seeking behavior: *see* Companies Law, Art. 7-11, 21-23.

The Revisions have so far kept to this scheme, improving it slightly, but there seems little interest in grappling with the 'real' problem so far: repealing and replacing the MOLL Decrees and Circulars discussed by Tabalujan (1996, 903). A better basis for an increased cost, delay, and corruption than MOLL Decisions No. M.01 & M.03-PR.08.01/1996 (Approval of Articles of Association and their Amendments) is difficult to imagine, especially when they are combined with the annual 'Trade Registry' filings required by the Ministry of Trade and Industry: MOIT, another reputed source of rent-seeking. The MOIT filing format is completely different from the MOLL's, of course. The ostensible reason for MOIT filings, accurate statistics, is belied by the fact that only 28% of companies bother to file and statistics are (apparently) not compiled from this source. Nonetheless, MOIT plans fresh regulatory interventions: 'Only 28%…,' 2000.

The unlimited liability of company founders during the lengthy delays that surround registration is a risk that inhibits a company's formation and its prompt operation. Mere notice-filing, once and presumably at the MOLL, would put other (autonomous) business people on inquiry, to protect themselves by such contractual, etc. means as they choose. Any other 'public interest' is difficult to imagine, much less one trebly 'protected' by notaries, the MOLL, and the MOIT. Any demonstrably misbehaving company can always be de-registered, after the fact. At the least, the relatively minor matters described by Companies Law Art. 15, 39, and 106 can be the subject of notice-filing, rather than a MOLL approval prior to a registration.

Other problems surrounding registration merit our attention. Current MOLL practice, under the Decisions above and the vague provisos of Companies Law Art. 2 and 8(1)(b), is to register only those companies which have extremely narrow and specific activities/purposes/objectives. This specificity is reinforced by a strong Dutch-style '*ultra vires*' rule, to limit a company's ability to adjust quickly to changing business conditions and opportunities--so as to promote economic growth. According to Ahmad Habir (1999, 182-83), this practice also fosters the formation of 'conglomerates.' He gives the timber business as an example: typically, one company cuts down the trees, another processes them, a third markets the resulting wood products, and no company can be held responsible for the unlawful eviction of forest peoples or the land-clearing fires that damage the environment. Indonesia also loses the 'natural' efficiencies that can be achieved through a vertical integration of such economic activities in one company, and that does not (as such) offend the Competition Law (No. 5 of 1999).

Art. 2 of the Companies Law should thus be amended to read: 'Unless its activities are limited by the Articles of Association, a Company is formed to conduct any business which is not contrary to laws and regulations, public order, or decency.' (*See* OECD, 1999, 14-15; Tabalujan, 1996, 887). **{{**Art. 6 and 8(1)(c) would benefit from an additional sentence: 'If the Articles of Association state no duration for the Company, it is presumed to be perpetual.' This kind of 'default rule' avoids the adverse consequences of an omission from the Articles that is not caught by the MOLL Registry officials.**}}** Art. 7a(4) in the current Revisions still requires two or more company founders. This makes it impossible for a single biological person to found a company, or for one company (a single person in law) to form another company as a wholly owned subsidiary. **{{**Such events are common in the commerce of other countries, and their prohibition reduces an Indonesian 'freedom of enterprise'.**}}** This prohibition is apparently based on the legal fiction that a company is not a simple choice of form for economic activities, but a 'contract' between at least two people. (n.9)

When we move from its registration to its 'governance' provisions, we see that the Companies Law is rather more successful. Many small 'technical' changes too numerous to detail here would enhance transparency, accountability, and participation, but this is true of the laws in other countries, too. Thought could be given to making a costly, two-tier board structure (commissioners versus directors) optional, as in France, especially as company commissioners are felt to play no meaningful role in Indonesia. But this is probably too radical a reform to succeed, in the face of strong preferences for Dutch law among some Indonesian advocates. (n.10)

The essence of a companies law governance is seen as maximizing (an interrelated) company value and efficiency, by mediating the roles of four classes of participants: major blockholders (the owners of large blocks of shares), company managers, minority shareholders, and creditors. These categories collapse in the many closely held companies of Indonesia—the major blockholders are typically the managers as well, and minority shareholders sometimes do not exist. The important potential role of such minority shareholders, as equity financiers through a capital market, suggests that their interests could be most efficiently protected through reforms in the Capital Markets Law. (This would lessen an excessive dependence on a debt finance among Indonesian companies.) Existing provisions in the Companies Law provide modest protections, without giving minority shareholders many opportunities to veto enterprise-favoring decisions. (n.11) All of this puts a heavy premium on the relationship between major blockholders and creditors in Indonesia, a relationship left problematic by a new and uncertain Fiduciary Transfer

Registration Law, a failed Bankruptcy Law, the mostly-ineffective activities of IBRA and the Jakarta Initiative (*see* Brietzke, 2000), and archaic Companies Law reorganization provisos (*infra*).

In policy terms, *potentially* self-interested transactions by the managers/major blockholders can be prohibited too broadly as well as too narrowly. There is a need to foster cooperation (minimize coordination costs) within the enterprise, and unduly curbing the discretion of managers and/or major blockholders reduces enterprise efficiency--by increasing transaction costs (note 4, *supra*). This in turn has the effect of giving other participants (minority shareholders, creditors, etc.) the opportunity to hold out (in a frequently-successful quest for rents) by threatening to veto enterprise-favoring decisions. By accident or design, Indonesia's Companies Law gets this difficult balance more or less right, although 'fiduciary duties' can be better defined and something like the 'business judgment rule' should be added. (n.12)

More systematic Companies Law reforms which are tangentially related to governance matters are arguably needed in Indonesia: improving the flows of information within and around the company, and making the participants' remedies as self-enforcing as possible—to minimize interventions by costly, time-consuming, and perhaps corrupt judges and bureaucrats. Information is a scarce and valuable resource that readily translates into an interchangeable wealth and power: *see* note 4, *supra*. Fuller information operates to empower 'outsiders' and to thus promote transparency, and tends to a distribution of company wealth that better approximates the participants' economic productivity (i.e., that minimizes rent-seeking opportunities). The 'insiders' have their own sources of information, which is a major reason why they have paid (in various ways) to become insiders. (n.13)

Underdeveloped Indonesian intermediaries (*infra*) and markets cannot be expected to generate the volume of reliable business information available in some Western economies. Rather, 'good news' tends to flow upwards in the hierarchy of a complex enterprise (public or private), to please one's superiors; 'bad news' tends to flow downwards, to cow one's subordinates; and little or no news flows sideways in the hierarchy or leaks outside of it—to citizens, creditors, minority shareholders, or would-be investors—so that insiders can continue to control their sources of information/wealth/power.

Command and control as well as accountability thus suffer when information is scarce and imperfect, creating an inefficient uncertainty and problems of enterprise and legal design: it is as easy to stipulate duties to disclose as it is difficult to then enforce them. Nonetheless, it is worth attempting to curb opportunistic behavior through better definitions of what must be disclosed, when and by whom, and the consequences of non-disclosure. The Corporate Governance Code accomplishes part of this task, *infra*. These duties should otherwise be made as self-enforcing as possible (*infra*), and revolve around the details of potentially self-interested transactions and a wide dissemination of regular 'international standard' audits. (Coffee, 1999, 690-92; Goldman, 2000; *see* Black and Kraakman, 1996, 1932, 1974.) A much less strict (but better-informed) regulatory regime should offer a *quid pro quo* for these expanded disclosures.

{{Proposed Dutch reforms (Secretariat, 1997, s. 7) focus on enhancing the commissioners' monitoring functions, but this is unlikely to prove effective—in Holland or especially in

Indonesia.**}}** The Indonesian General Meeting of Shareholders (GMS) 'is entitled to obtain any information' (Art. 63(2)), but the GMS is stuck with such manipulated information as major blockholders and managers choose to provide: for example, Art. 59(4) does not stipulate the contents of the annual statement. The threat of a (Dutch-style) judicial investigation of an 'unlawful act', under Art. 110-13 and levied by at least 10% of shareholders, should in theory elicit the kind of information and behavior that makes so costly and cumbersome an investigation less likely. But this possibility is mostly ignored, perhaps because disgruntled shareholders get bought off.

The most serious informational problem is that Indonesian Financial Accounting Standards (Tabalujan, 1996, 896-97) are archaic, chaotic, and sporadically and corruptly applied. This increasingly leads to the use of audits by multinational accounting firms, but the results are frequently disappointing. International accounting standards are being agreed much too slowly to have an impact in Indonesia in the foreseeable future.

The model of a self-enforcing companies law is Black & Kraakman's (1996): mandatory as well as enabling rules, enforced directly by the injured participants and against the miscreants wherever possible. The conspicuous failure of this model in the main country where it has been promulgated, Russia (Fox & Heller, 1999, 45), does not mean that an Indonesian-appropriate design would not add substantial value to Indonesian companies. The emphasis would be on bright-line rules that can be readily understood by the participants, rather than on the vague standards that require a costly and time-consuming second-guessing, by possibly incompetent and corrupt courts. (n. 14)

For example, approval by directors (an indirect democracy) *and* shareholders (the direct democracy akin to referenda in a public-sector governance), and/or creditors in some instances, should be required for certain transactions. (Creditors need other mandatory protections as well, to stop insiders from grabbing what they can from a sinking ship--Black & Kraakman, 1996, 1970—especially given Indonesia's currently-ineffective bankruptcy regime.) The insiders' failure to obtain such an approval (and the like) should attract a harsh legal remedy (running directly to injured participants), to compensate for the low probability of such a remedy succeeding in fact. Perhaps needless to say, insiders will still engage in a secretive self-dealing, and thin capital markets and the absence of effective appraisal remedies will limit the disgruntled shareholders' right to exit. But insiders' actions will be informed by knowledge of their vulnerability to a subsequent exposure and possible sanctioning of their schemes.

{{To succeed, such a process would require improved sources of information (*supra*), a fairer and more secretive voting which is independently tabulated, and especially the cumulative voting that gives minority shareholders a chance to select sympathetic directors. At the price of modest increases in transaction costs, these additions to Indonesia's Companies Law would enhance its self-enforcing nature and thus markedly reduce other transaction (monitoring and enforcement) costs. These legal reforms would better match power with the incentives to increase company value.**}}** Unlike the prohibitions that are seldom enforced by inattentive or corrupted Government officials, self-enforcing provisions merely erect procedural hurdles. Company participants who are injured have the incentive to reinforce these hurdles, which are not so high that they cannot be surmounted for company-benefiting transactions. (n. 15) Existing

Indonesian Companies Law hurdles could always be improved, but they are not too bad from this perspective: *see* note 12, *supra.*

As a last resort, the *locus standii* of participants who may be injured by company decisions should be clarified and reinforced. Issues which pose transaction-cost versus 'fairness' dilemmas should also be dealt with: What measure of standing in court should fall to, e.g., consumers claiming injury from the company's products or residents claiming injury from the company's pollution? In comparison to the appraisal (Art. 55), preemption, participation, takeout, and other direct remedies that are mostly neglected under Indonesian Law, the 'derivative' suits, mediated through the company under Art. 85(3), 98(2), 110(3), and 117, are less effective and certainly more costly incentives. (n. 16)

Dissolution and liquidation (Art. 114-24) are the company's death penalty, the end of the company lifecycle. There is no 'interface' concerning the behavior of liquidators and judges, between the Indonesian Companies Law and the archaic 1905 Bankruptcy Law, much less the (seriously-defective) 1998 Bankruptcy Amendments and the currently-pending Draft Amendments: *see* Brietzke, 2000. One wag describes these Amendment processes as 'rearranging the deck-chairs on the Titanic'—on a leaky Dutch galleon might be a more apt metaphor. But help is on the way in the form of a Corporate Reorganization (American Chapter 11-style) Draft Law.

Companies Law Revisions should facilitate such voluntary reorganizations and, at the least, the creditors' right to file claims up to two years after the registration of a dissolution, under Companies Law Art. 121, should be abrogated. Creditors will suffer primarily because the intermediaries (*infra*) and competitive markets that spread and diversify information and risks in other countries are usually absent in Indonesia: *See* Black & Kraakman, 1996, 1967-68. The public prosecutor's role under Art. 117 would seem an inconsistent duplication of powers which are already overly criminalized by the Bankruptcy Law, and should be deleted or at least harmonized.

Reorganization is a redesign to forestall the end of a company's lifecycle, and/or to make it more efficient (Bergloff & von Thadden, 1999). Difficulties in amending Indonesian articles of association, *supra*, frustrate some or many reorganizations. These are otherwise dealt with narrowly--purely as an issue of mergers and acquisitions--under Indonesian Companies Law Art. 102-09. Such transformations are made all the more pressing by the near-failure to deal with the consequences of the Indonesian *Crismon*, through devices erected outside of the Companies Law: chiefly bankruptcy, IBRA, and the Jakarta Initiative (Brietzke, 2000). At stake is the premium or deficit associated with control over a company, and who has the right or the duty to claim it. While reorganization may increase enterprise efficiency, it is also a popular way for insiders to loot company assets or its control premium. Approval by a supermajority of shareholders is thus commonly required in other countries (n. 17), and the relevant numbers for merger *or* dissolution in Indonesia (Art. 76) are set very high: approval by at least 75% of shareholders voting—who must constitute at least 75% of all shareholders. A few shareholders can thus act as 'holdouts' who defeat a company-favoring step by simply not showing up at the relevant meetings.

The Companies Law of mergers vaguely requires that the interests of the company, minority shareholders, employees, the public, and 'fair competition' be taken into account (Art. 104(1)). Revisions must bring these merger provisions into line with the Competition Law (No. 9 of 1999), especially Art. 27-29 of the latter. What should the Revisions do about the mergers that are also hostile takeovers? (*See* Coffee, 1999, 658-59; Fox & Heller, 1999, 45.) These are frowned upon by Dutch Law (Secretariat, 1997, s. 5), and by European law generally (although France and Germany seem to be growing more permissive), as disruptive of company continuity. But in America and a few other places where capital markets are admittedly more liquid than Indonesia's, the threat of a hostile takeover is thought to increase managerial efficiency and reduce the exploitation of minority shareholders.

Hostile takeovers are tacitly defeated in Indonesia by the elaborate Plan that the relevant board of directors must prepare (Art. 102(2), 103(3)-(5)), a Plan to be approved by a supermajority of the GMS and by the Ministry of Law and Legislation (MOLL) in turn (Art. 105-06). *See* Scott, 1999, 23. Is the intended policy to make hostile takeovers impossible, is this tendency merely an inadvertent artifact of an over-regulation, or does a continued insider control make such takeovers impossible—regardless of Indonesian law?

Two kinds of Indonesian companies deserve separate analyses: family firms (Habir, 1999) and intermediaries (Brietzke & Timberg, 1999, 27-28). The Preamble (para. d) makes the entire Companies Law subject to 'family principles', under a vague 'economic democracy', Pancasila, and the 1945 Constitution. But family companies have come under an increased and politicized scrutiny: 'Strong Managers, No Outsiders', instead of the merely close-held pattern (*supra*) of 'Strong Blockholders, Weak Minorities' (Bergloff & von Thadden, 1999, quoting Mark Roe). The mingling of strong families with Government breeds the 'crony capitalism' that is not unique to Indonesia, and that triggers concern with public sector as well as private sector governance issues. It involves a strong preference for dealing with established trading partners, a board composed exclusively of economic allies, and a cross-ownership and conglomeration based on the factors discussed *supra* and on the desire to expand into any business where a political opening occurs. (n. 18)

The Economist ('The End…', 2000, 75-76) argues that such companies are less a product of 'Asian values' than of a Victorian, Wilhelmite, or American, 'robber baron' capitalist development. Either such companies will disappear or become transparent, shareholder-friendly companies (like Ford or Siemens), a transformation that will now occur rapidly because the Asian crisis has disrupted the cronies' balance sheets. As financial and regulatory regimes get cleaned up, insider trading and competition policy enforcement becomes more rigorous, and contracts and capital markets get used more efficiently, enterprises based on trust within the family will evolve or die. So narrow a trust is efficient only in exceedingly imperfect markets, since you cannot trust everyone you must deal with--to achieve efficiency in a complex and impersonal modern economy. This is especially true of the crony/conglomerate, relationship-based investment and debt finance that increasingly leads to capital misallocation and a stifling of entrepreneurship. The absence of arms-length contracts and third party interventions in family firms leads to new business opportunities not being recognized or exploited effectively. (*Ibid.* 78, quoting Simon Cartledge in part; Bergloff & von Thadden, 1999; Coffee, 1999, 706.)

The logic of this argument is impeccable in economic theory, but it is widely distrusted by Indonesians in practice—including by some prominent economists. The well-founded fear is that tycoons and cronies will forestall the implementation of law reforms and the other market perfections that would spell the economic and political demise of the big family firms. The principled cultural differences (*supra*) between many Indonesians and their international aid donors on this subject concerns the (rather touchingly naïve) faith the donors have in the capacity of market-based reforms to fix everything. Some reforms that the donors want—hopefully, not those described here—may serve to entrench tycoons and cronies old and new, at least temporarily. Most Indonesians thus focus on mandatory Companies Law rules, plus the (unsuccessful, so far) prosecutions for corruption, etc. of identified tycoons and cronies. This concern with retribution as well as public sector governance comes at the expense of dealing with those who would now assume the roles of the tycoons and cronies of old.

Intermediaries are particularly underdeveloped in many countries like Indonesia, especially after archaic transactional formats and poor risk management were subjected to the *force majeure* of the Indonesian *Crismon.* Intermediaries include banks, less formal and smaller-scale lenders like credit unions, insurance companies, equity brokers operating through the Stock and Commodities Exchanges, and other financial intermediaries. The latter group includes, among others, sophisticated lawyers and accountants who evaluate and diversify risks for their clients, financing factors who buy accounts receivable and monitor the borrowers for smaller creditors, and propriety information services which compile borrowers' repayment records, etc. A better intermediation and equity marketization from such companies would enable banks to cut costs, diversify risks, and feel less of a need to act like major blockholders.

Stimulated through the creative use of a deregulated contracts regime (*supra*), such intermediaries would lengthen time horizons by facilitating enterprise planning opportunities. They would diversify and spread risks, communicate reliable information cheaply (*supra*), help to hold other enterprises accountable, and strengthen markets and access to them. This developmental (market-perfecting, by reducing informational asymmetries) potential deserves a separate reformist treatment that is beyond the scope of this article, one that revolves around a selective re-regulation under reformed administrative laws and the new learning in the economics of risk management. (Black & Kraakman, 1996, 1923-24, 1967-68; Brietzke & Timberg, 1999, 27-28; Coffee, 1999, 647.)

In sum, relatively modest Companies Law reforms should be used to redesign incentives and organizations along more economically rational lines, and also to increase the opportunities for specialized redesigns by company participants. Indonesian enterprises would then cope better with a variety of market, legal, cultural, judicial, and other institutional constraints. A better balance should be achieved between mandatory and default rules, a balance that is directly enforced by injured participants wherever possible. All of this can be done without severing too many of the links to a Dutch legal heritage that some Indonesian advocates value. An enhanced enterprise legitimacy is at least as important as an increased efficiency in Indonesia: fairer (productivity-based) distributions to company participants will reduce the tendency to scandals over Indonesian companies, and thus build investor and public trust. (n. 19)

Corporate Governance Code

While I argue that only relatively modest Companies Law reforms are required, four financial economists give Indonesia the lowest scores of any country surveyed in 1998—for shareholder protection and legal enforcement: Scott, 1999, 25. This apparent discrepancy is best explained as part of the yawning gap between the formal law and its practical implementation (*supra*) that is seen throughout Indonesian legal system, a gap I earlier attributed to cultural and political/rent-seeking factors--rather than primarily legal or economic factors. (n. 20) Such a quasi-legal gap arguably requires a quasi-legal treatment, and one such treatment recently became available in the form of a (Draft) Corporate Governance Code.

Corporate Governance is a broad and amorphous concept (n. 21), so it is by no means clear what such a Code must or even should contain. Competent and committed reformers (Jusuf Anwar, Mar'ie Muhammed, Erry R. Hardjapamekas, Ahmad Fikri Assegaf, *et al.*), the Code drafting Committee will include reforms that the (more reticent and Dutch/regulatory-oriented) Companies Law Revision Drafting Team do not choose to include. Subject to fewer of the formalities of the law reforms that disturb business expectations, 'evolutionary' Code principles can quickly be changed to reflect new thinking, cultural attitudes, and conditions. These new principles could be added to subsequent Companies Law revisions, if the principles prove successful but need more formal sanctions for their effective implementation. Perhaps the most important role for the Code, one the drafters are willing to play at least in part, involves making the whole field of enterprise law more integrated and consistent: through 'directive principles' which give the field a conceptual integrity it presently lacks--*see supra* and *infra*. Experience in (re-)drafting and implementing the Code will undoubtedly inform more explicitly legal processes—especially on when and how courts get used.

The Code drafting Committee wisely focuses on integrating and changing Indonesian business cultures, *supra*. While a property rights- and market-based culture is certainly not new to Indonesia, it made little headway against other cultures and ideologies for many years. The current transition to democracy makes possible the fuller flowering of this culture, but how can it displace rent-seeking to become part of the businessperson's feeling of self-worth, as well as an index of enterprise value? The Committee rightly feels that the educative, hortatory aspects of the Code will enhance enterprise efficiency and legitimacy, and thus increase Indonesia's global competitiveness. Businesspeople increasingly accept globalization, and even a possible surge in cross-border mergers and acquisitions, as serious constraints on the cultural distinctiveness of Indonesian business.

Culturally, the Code spells out the business details of 'don't lie, don't cheat, don't steal, keep your promises, and otherwise build trust and improve your reputation': *see* Fox & Heller, 1999, 2, 5; 'Doing Well…', 2000, 71-72. Even through the informal methods of the Code, incentives can be re-structured so that a 'corporate conscience' is no longer unprofitable and thus an oxymoron. All enterprise laws are vague about what responsible, good faith behavior looks like—especially Indonesia's, where judges seem to be decades away from the serviceable definitions and the other gap-fillers that the Code can offer immediately. (n. 22)

The cultural success of the Code will turn on building links with a more generally popular, democratizing culture. The Code could be socialized as a needed supplement to democratization (good public-sector governance), by creating a freedom of enterprise and thus citizen autonomy in a stronger civil society (*supra*). The Code can be treated like the ‘organic’ features of a constitution or of family law: explicit designs of ‘relationships.’ While the Companies Law may regulate some of the ‘trees’ (the details), the Code gives a better sense of the ‘forest’—an enterprise ‘ecosystem’, where the whole is greater than the sum of its parts.

In the civil law tradition, these organic features must then be fleshed out, through the Committee’s *and* business people’s interpretations and practices that give organic features their concrete meaning. This will sometimes or often prove a better way to implement enterprise policy, when compared to complex, ‘one size fits all’ rules which are sometimes misapplied or applied corruptly. Political meddling in enterprises is inevitable to some extent, but it can be reduced by strengthening the self-governing features of the Code.

This is a different process from a formally legalistic one, and the hallmark of the Code is a greatly reduced reliance on formal sanctions—especially of the punitive, top-down, regulatory variety. Since such sanctions are basically what characterize law in Indonesia, the Code should be described as a quasi-legal process: informal ‘compliance measures’ will likely spring up, such as commentary by non-governmental organizations, independent auditors, or the Capital Markets Authority (BAPEPAM), to the effect that a company and its annual report does or does not comply with Code particulars.

This informality is simultaneously the strength and the weakness of the Code, and capitalizing on its strength requires some creative thinking. When, how, and why should which formal or informal sanctions fall on an enterprise, or on certain of its participants—to maximize enterprise efficiency and legitimacy? For example, where no broad ‘public interest’ is at stake, the Code can simply hold the enterprise ‘responsible’, leaving it to disaggregate this burden among enterprise participants. They can in turn contract among themselves for the monitoring, etc. that best improves governance in a particular company (within the hitherto-narrow limits posed by Indonesian law). This relieves regulators and courts of the costly and often-corrupting burden of determining which participant(s) are actually responsible. (n. 23)

Many comments could be made about particular Principles (Prin.) in the Code (Draft 3.1), and a few points will be raised to give the reader the ‘flavor’ of the Code. The Committee Drafters are particularly sensitive to the flow-of-information problems (n. 24) discussed *supra*. The Note to Prin. 1.4 properly stresses a broad duty of disclosure, and the contents of the annual report are stipulated in Prin. 7.4 (rather than by Companies Law Art. 56, 59(4)), but there is only a formalistic compliance with such duties in most other countries. The relevant duties should thus be stipulated in greater detail, with creative ‘compliance measures’ attached, particularly with regard to disclosing ‘matters…of material importance to the decision-making’ of enterprise participants (Prin. 7.1), in a timely and accurate manner (Prin. 7.3). For example, must/should an enterprise disclose its productivity increases to a labor union (a ‘stakeholder’, *infra*), which will use these as the basis to demand wage increases—and perhaps to strike later? If so, this will reduce the company’s incentive to collect such information in the first place, or increase the incentive to overstate productivity for shareholders and understate it to unions? Which, if any, consequences should then follow?

Prin. 4.4 and 8.1 create a broad duty of confidentiality, but how should this be balanced against the rival duty to disclose in Prin. 7.1-7.3? How, for example, can the economic value (or lack thereof) of a trade secret be disclosed reliably, without disclosing the secret itself? Internal audits and other controls, external audits, and an optional Commissioners' Audit Committee (which could be made 'mandatory' for larger enterprises) are usefully stipulated in some detail (Prin. 3.6, 4.1-4.5). But there is no requirement of conformity to standard accounting practices, probably because these standards have been evolving only slowly in Indonesia. Some of the systems currently used in Indonesia could be recommended under Prin. 4.1 however, and model audit regulations could be created under Prin. 4.5. (n. 25)

Specific internal controls could be stipulated for specific kinds and sizes of enterprises, under Prin. 3.6. The Committee or BAPEPAM could then comment on the presence or absence of these controls. The Code could also list the most common kinds of opportunistic behavior, and how and why they are frowned upon: details about conflicts of interest, self-dealing, minority shareholders acting as holdouts, etc. that flesh out provisos discussed in note 12, *supra*. A Company Secretary is usefully stipulated (Prin. 5.1-5.5), to oversee internal controls and compliance with disclosure requirements. Especially as stipulated in greater detail, these Code principles will enhance the Indonesian outsiders' ability to 'monitor the monitors' (*supra*).

Prin. 9.1 provides that a defined class of 'insiders…must not take advantage of inside information': *see* Anwar, 2000. What constitutes abuse of this informational asymmetry should be defined much more precisely here, since insider trading causes serious conceptual problems in all countries where it is prohibited. While Blair (1999, 13) reports on an intense debate about whether foreign laws 'ought to be brought up to the U.S. standards', I argue that merely hortatory statements properly belong in a quasi-legal Indonesian Code: an insider trading prohibition is unenforceable anyway—probably because it contradicts human nature and ingenuity. (Like it or not, the driving force behind much of enterprise activity is the opportunity to profit from inside information, in ways so sophisticated that they frequently remain undetected by enforcement authorities more experienced than Indonesia's.)

A conceptual and political struggle continues worldwide, between a shareholders' and a broader 'stakeholders'' approach to governance issues. The Indonesian Companies Law mostly attempts to protect shareholders and creditors only, while the Code's drafting Committee tries to protect everybody. This seems to echo the Dutch and German approach that has been widely regarded as a failure, especially since the introduction of a 'co-determination': labor union, etc. representatives on the boards. For example, Indonesian Code Prin. 2.2 says that at least 20% of Commissioners 'should' be outsiders, to increase 'transparency and effectiveness'. However, in other jurisdictions, 'insiders' tend to hold the 'real' meeting first, to decide what will be presented to outside representatives as an accomplished fact. If the Code were to go further and require that dissenting opinions by outsiders be presented to the General Meeting of Shareholders (GMS), there would then be the need to cut off ill-founded presentations and debates by, e.g., a 2/3 vote of the GMS.

Code Prin. 1.3 usefully imposes distinct responsibilities on minority as well as controlling shareholders, but implicit in Prin. 1.4 (and explicit in the Companies Law) is the notion that the GMS exerts significant control over the company. There is much hard evidence to the contrary, in Indonesia and many other countries, and Prin. 1.2 mandates a more realistic 'equitable treatment' of shareholders. In the nature of things, minority shareholders (much less the other stakeholders) cannot be insulated from many of the risks discussed in this article, but their position can be tempered by a Golden Rule (or Immanuel Kant's Categorical Imperative): act toward minority shareholders, etc. as you would have them act toward you, were your situations reversed. So flexible a Code principle, perhaps blended with more specific BAPEPAM regulations, would be a less demanding standard (more of a risk-sharing among the participants) than the 'good faith and full responsibility' standard adopted by the Companies Law: note 12, *supra*.

The stakeholder approach goes far beyond these modest protections, and has the superficial (at least) appeal of fairness and promoting broader socio-political goals. These goals are unlikely to be implemented in reality however **{{**, and stakeholder-ism can evolve into the corporate syndicalism that became fascism in some countries}}. In any event, those who supposedly represent diverse stakeholders can frequently extract rents as the price of their consent to an enterprise action. There was too much of this elitist and inefficient behavior in Indonesia in the recent past, and the Committee must unfortunately decide which group(s) to favor, when and how. Pagano and Volpin (2000) approach this matter as a series of tradeoffs: for example, they find low investor protection and levels of mergers and acquisitions correlating with a high level of employment protection. They note that most countries in this position are moving toward greater investor protection and more M & A activity, at the expense of employment protections.

Code Prin. 6.1 (Note) defines stakeholders as communities, employees, customers, suppliers, creditors and affected environmental groups, and Prin. 6.2 offers these stakeholders 'the appropriate means by which to monitor and offer input…' These 'appropriate means' should be defined carefully: they presumably do not include the 'standing' to sue that is defined by other laws, but should they include, e.g., an entitlement to 'good will' payments made to the local community? (Such payments necessarily come out of the enterprise's treasury or distributions to shareholders.) (n. 26)

Small businesses offer excellent examples of Anwar's (2000) analysis of enterprises being driven by compliance with regulations, rather than voluntary ethical standards. A comprehensive deregulation (especially the repeal of Law 9 of 1995) of these small businesses would be the quickest *Crismon* fix through law, (n. 27) along with an inexpensive, simple law for small companies. Pending such reforms, the Committee should indicate, perhaps in their Notes, how Code principles should be applied by and to small businesses: robustly, but with allowances made for differences in scale, resources, and access to expertise.

Both the Code and the Companies Law Revisions are designed to apply to State-owned enterprises (SOEs). Pending the reform (really the creation) of Indonesian administrative laws, a step so far lacking the requisite political commitment, the Companies Law and the Code are all of the guidance these rudderless enterprises will get. For example, Hardjapamekas (2000) stresses timely disclosure, commissioners' independence, and the fair treatment of private (especially foreign) shareholders in SOEs--through the Code. The IMF has mandated privatization of these SOEs, so far wholly in a law-less fashion, and the Code should address this issue also.

Conclusion

The Code drafters are determined to introduce reforms that the more reticent and Dutch/regulatory-oriented Drafting Team for the Companies Law Revisions will likely ignore. Future interactions between these divergent but complementary approaches will involve a series of difficult tradeoffs, hopefully adjusted in the light of experience to increase Indonesian company value—efficiency and legitimacy. I have argued that this process requires effective, legal and quasi-legal curbs on a shirking and rent-seeking among Government officials, professionals, and (to the extent of a separation of ownership and control) company participants. An important piece of enterprise law reform would then fall into place, while the other pieces require more thought and the sustained political will to reform. If these materialize, Indonesians will get the integrated and consistent, economically rational and culturally appropriate, enterprise laws they deserve.

End Notes

1. Many of the arguments in this section are based on Brietzke, 1999 and Brietzke and Timberg, 1999, or will be generalized and developed in projected articles with the working titles of 'Law: Under-categorized and Over-determined', and 'Immaculate Misconception: Law Reform in "Transition" Societies.'

2. Brietzke and Timberg, 1999, 16-18. The civil law attempts a highly prized coherence and consistency, by fully stipulating all forms and statuses in advance. But in all legal systems, analyses consistently boil a large number of legal artifacts down into only a few status-categories. Call it 'legal science', but it frequently seems like a simple-minded pigeonholing--especially to non-lawyers.

3. No. 42 of 1999. See Brietzke, 2000.

4. Transaction costs can and have been described in many different ways. For our purposes, they are best imagined in six categories: search costs, those of finding the employees, suppliers, investors, creditors, etc. to deal with; negotiation costs, those of hammering out agreements with them; monitoring costs, those of determining whether the agreements are being performed— the largest single transaction cost in more complex enterprises; enforcement costs, those of somehow obtaining remedies when the agreements are not performed (*see* self-enforcement, *infra*); coordination costs, those of promoting the collaborations of various sorts that are conducive to economies of scale and scope; and costs of learning from mistakes and re-designing incentives and enterprises accordingly.

The most efficient enterprise (of its type) has the lowest *net* of these transaction costs. For example, if almost all agreements are performed anyway, it makes little sense to engage in costly negotiations concerning all contingencies. But this will probably cause monitoring costs to increase, and will certainly increase enforcement costs; it is all a question of how much negotiation is cost-effective—measured in terms of what happens in other transaction-cost categories. Brietzke, 2000 **{{**; Black & Kraakman, 1996, 1919: corporations law 'minimizes the sum of the transactions and agency costs', especially through the 'default rules' that can be modified in the articles of association, etc. (This facility is narrowly limited by Indonesian law.) **}}** Particularly high and pernicious costs arise when self-interested transactions are attempted by those with a significant control over the enterprise: *infra*. **{{**Such misuse of enterprise resources, and related failures in pro-rata distributions, call for limited legal protections of creditors, minority shareholders, etc. Black & Kraakman, 1996, 1958; Fox and Heller, 1999, 14, 18-19; *infra*, notes 11-12 and accompanying text.}}

Please note that almost all of these transaction-cost categories concern contractual costs, and that all of them are costs of information. Economic incentives (salaries, profits, etc.) can be built into the relevant contracts (subject to the strict limits posed by over-determined Indonesian laws, *supra* and note 6, *infra*) which reduce rent-seeking and shirking, but such contracts are difficult (costly) to enforce—especially through the courts or an ADR in Indonesia. Innovative, self-monitoring techniques and self-enforcing remedies are thus efficient: *infra*. Transaction costs are also information costs: who to deal with, what terms are mutually acceptable, what performance is actually occurring, how to remedy mis-performance and non-performance, and how to coordinate and to re-design for maximum efficiency. How well an enterprise (and the law applicable to it), handles such information flows (a scarce and valuable resource), in and around the enterprise, will play a significant role in business success or failure. Brietzke, 2000; *infra*. **{{***See* Black and Kraakman, 1996, 1924: where 'informational asymmetries are severe, [and] markets are less efficient, contracting costs are high because standard practices have not yet developed' [or are prohibited, through over-determined Indonesian laws].**}}**

5. Alchian and Demsetz, 1972, 777, 781-83, 794; Berle and Means, 1932, 2-6; Coase, 1960; Roe, 1994, 194-95, 235-37; Williamson, 1985. {{ For the antithesis of this approach, see the (Dutch) Secretariat Committee, 1997, s. 5: There is normally no reason to separate finance and influence during the Shareholder's Meeting. }}

6. *See* Black & Kraakman, 1996 and Coffee, 1999, 651, distinguishing academics' corporate law models—enabling (e.g., in the U.S.), mandatory (e.g., in Holland, Germany and Japan), and self-enforcing (abortively, in Russia); and Tabalujan, 1997 and 1996 (the best general sources on the current Indonesian Companies Law). This Law is 'an important, if modest' step that received a 'rather smooth' implementation. The Dutch heritage is evident in a two-tier (commissioners and directors) board structure, formal investigation of misbehavior procedures (Art. 110-13, *infra*), and minimum capital requirements. The duties of those involved with the company echo equitable (common law) standards, in what amounts to a "unique mix" among legal families. Tabalujan, 1996, 890, 907-08. **{{** With weaker market controls and, consequently, facing a greater measure of insider control, European companies laws prohibit 'a wide variety of corporate behavior in considerable detail': Black & Kraakman, 1996, 1930.}}

   The European-style, mandatory nature of the Indonesian Law (forestalling a customizing of the enterprise under the parties' contracts) is illustrated by, e.g., minimum capital requirements (Art. 25-26) and the long list of elements which must be included in the Articles of Association (Art. 12). The Ministry of Law and Legislation (MOLL) refuses to register companies with Articles which include elements in addition to those on the list, and a long list of amendments to the Articles (by notary deed) must be approved by the MOLL (Art. 15). The MOLL is granted a broad discretion, here and elsewhere—e.g., Art. 19—and the Revisions, *infra* note 7, are unlikely to change this much. **{{** *See* Revisions Art. 46(4), perpetuating the narrow limits on the classes of shares in Indonesia that (according to many Indonesian advocates) unduly restrict management's freedom of action. 'Default' rules, those permitting a contractual customizing, are limited to, e.g., variations on share transfer rules (Art. 50-51). }} At the least, the MOLL could, by Regulation, approve certain Articles of Association and Amendments in advance, including a fairly wide range of choice among options. Also, many small changes in property and contracts law would increase the efficiency of enterprises and the markets in which they function. These reformed 'private' laws would give more of a free rein to individual projects, most of which are of no concern to the general public. These 'freedoms' should thus be regulated only when a clear social injury threatens. Brietzke and Timberg, 1999.

7. Draft of Companies Law Revisions (as of March 15, 2000), translated MS in the author's possession. This revision process has been delayed, and the Drafting Team has agreed small changes to only one-third of the Law as of this writing: *see* note 8, *infra*. {{ There is a law-reform 'logjam' in the DPR (Parliament), and this seems to lessen the felt need to send more reforms promptly, according to previously-established timetables. But }}there also seems to be a difference of opinion within the Drafting Team, between those who would make cosmetic reforms only and those who would make a few more fundamental reforms. **{{** Whether the latter reforms will move in less mandatory and more self-enforcing (*infra*) or enabling directions remains to be seen, of course. Despite reform efforts, inefficient rules may persist because they cater to rent-seeking by influential groups—banks in Japan and unions in Germany, for example: Coffee, 1999, 654. }}

8. *Compare* 'Indonesia Signs…' (2000) (full text of Jan. LOI) *with* 'Memorandum of…' (2000) (full text of May LOI). *See* note 7, *supra* . {{ These LOIs take the legal form of an 'agreement' between the parties. But they are more like contracts of adhesion: Indonesia's bargaining power is narrowly limited by its pressing need for the 'loans' that are conditioned on Government signing. Whether such an agreement is 'enforceable' seems a cosmic irrelevance. }}

9. *See* Coffee, 1999, 641; Tabalujan, 1996, 890-92, 906. Such a fiction promotes the use of other fictions to circumvent it. For example, biological person X has 999 shares and Y (often X's relative) has 1 share, or PT (co.) X has 999 shares and Y has 1 share. Y is thus a person/PT of 'straw', whose presence serves no economic purpose.

10. *See* OECD, 1999, 42; Tabalujan, 1996, 890-92. {{ The OECD, 42-48, makes the governance question one of audits and of board(s) structure, functions, elections, and liabilities. }} While more transparency rather than less is obviously a good thing, Bergloff & von Thadden, 1999, sensibly note that companies find ways around most legal requirements in most countries. {{ Coffee, 1999, 641-43, notes that Berle and Means, *supra*, explain shareholder passivity in terms of a fragmentation of ownership. But Coffee then asks: What explains this fragmentation? He concludes that shareholder activism increases in direct proportion to the concentration of ownership, and that company governance issues will thus vary from country to country—e.g., ownership is remarkably dispersed in the U.S.--and be politically determined in large measure. If all of this is true, does it explain a relative shareholder passivity in Indonesia, where ownership nonetheless tends to be quite concentrated? What other, perhaps cultural factors are relevant? }} If Indonesia wants to make more effective use of bifurcated boards, commissioners should be given more rights, responsibilities, and the incentives to use these efficiently—to form an effective audit committee, for example: *see* Art. 94-101. (I put 'technical' changes in inverted commas in the text, to satisfy those readers who believe that all company law changes are technical.)

11. Bergloff & von Thadden, 1999. *See* Companies Law, Art. 63-78; *infra* note 12. The focus in East Asia should be on external equity finance, and thus on minority shareholder protections, given the current interaction of weak corporate governance concentrated family ownership, and excessive dependence on a debt finance: Scott, 1999, i. This is in sharp contrast to the much broader 'stakeholder' approach adopted by the Draft Corporate Governance Code, *infra*.

12 Bergloff & von Thadden, 1999; Black & Kraakman, 1996, 1931, 1971, 1974; Coase, 1960; Coffee, 1999, 644-45; Fox & Heller, 1999, 18-19; OECD, 9-11, 34-41. *See* Black and Kraakman, 1996, 1924-25 (the need to avoid the company scandals that breed investor and creditor overreactions, and that erode the legitimacy of private ownership); *ibid.* 1958, 1969 (self-interested transactions should be prohibited only where there is little business justification and a high potential for abuse; 'bogus' transactions should be blocked without impeding 'ordinary' business); *ibid.*, 1969 (thus, e.g., law should require creditor notification only if dividends or stock repurchases reduce the book value of a company's assets by 25%; larger creditors can always protect themselves anyway); Scott, 1999, 32, 34 (the central issue in East Asia is to improve conflict-of-interest protections); note 4, *supra* .

Major blockholders arguably have adequate power to run an Indonesian company efficiently: *see* Companies Law Art. 1(3), 71, 73-76, 115, subject to the threat of a judicial investigation (Art. 110-13). There are certainly some problems: e.g., Art. 55 compels repurchase of a shareholder's shares by the company, if an action affects a 'large portion' of company assets—although the Revisions will likely stipulate this as 50% or more. *See* the other shareholders' powers in Art. 66, 75-76, 88, 106, 117, requiring agreement of 10%-75% of shareholder's before various actions can be taken. While these percentages may be thought too low or too high in the particular instance, they are rather nicely calibrated to distinguish the most important areas for minority shareholder protection: in the 10% range. These provisos could more specifically define the parties, and the potential losses to the company or some of its participants, that trigger conflict-of-interest concerns.

Allowing a single shareholder to sue for 'unfair and unreasonable' company actions under Companies Law Art. 54(2) is too vague, and permits shareholders' rent-seeking: getting bought off by the company after threatening suit. It is also apparently inconsistent with the (perhaps mutually-inconsistent, but commonly requiring that suit be filed by at least 10% of shareholders) directors' Art. 85(3) liability for 'fault or negligence', and the commissioners' Art. 98(2) duty of 'good faith and full responsibility….' The latter standard comes close to a rather demanding fiduciary duty. A common formulation incorporating the business judgment rule should also be adopted: e.g., 'Directors and Commissioners are not liable if they act or forbear in good faith, without a conflict of interest and on the basis of information reasonably available when the decision was made, unless the decision lacks a rational basis.' In many other countries, such a rule is seen to encourage the economically appropriate measure of risk-taking. In contrast, Indonesian (and Dutch) standards have a moralistic basis rather than an economics one. *See* Schuern, 1997; OECD, 1999, 19: ordinary carelessness (arguably, an Art. 85(3) 'negligence') is too harsh a basis for liability, since major blockholders and managers will fear a second-guessing--by courts which have the benefits of hindsight and a broad discretion.

13. The hallmark of an informational asymmetry, insider trading is little regulated as such under the Companies Law: *see* Coffee, 1999, 690-92; note 12, *supra*. But the Capital Markets Law and the Draft Corporate Governance Code (*infra*) reflect modest efforts to do so.

14. OECD, 1999, 9. Compare the Indonesian situation discussed *supra* with Fox & Heller, 1999, 45 (primitive law and the lack of corporate transparency in Russia).
15. Black & Kraakman, 1996, 1932-33, 1936, 1945, 1947-48, 1950-51, 1978. {{ *See ibid.* 1940-41: Major blockholders can even erase shareholders from the company registry (unless reforms require that this registry be maintained by an independent body), so this kind of behavior should attract a severe penalty. But }} in a less over-regulated legal regime in other respects (*supra*), creditors and even shareholders could contract for their own additional, self-enforcing remedies.
16. Black & Kraakman, 1996, 1971. *Compare* OECD, 1999, 22 {{ (most companies laws do not permit shareholders to demand—in the appropriate circumstances--that the company redeem their shares, through an independent appraiser or a judge in default); *ibid.* 34. *But see }} with* Indonesian Companies Law, Art. 55.
17. Black & Kraakman, 1996, 1952; Coffee, 1999, 658; OECD, 1999, 20-21: Ideally, reorganization also includes separation of parts of the company, or transforming the whole or parts into different entities or even different enterprise types.
18. Bergloff & von Thadden, 1999; Coffee, 1999, 660, 662; Habir, 1999. The primary solution is not an improved corporate governance, but the wider availability of investment projects, the strengthening of human capital, and especially an increased governmental accountability. Bergloff & von Thadden. Citing a 1998 study by 4 financial economists, Scott (1999, 30) finds that 72% of Indonesian companies are family-controlled, compared to 67% in Malaysia, 48% in Korea, and 10% in Japan. Only 5% of Indonesian companies are 'widely-held', compared to 10% in Malaysia, 43% in Korea, and 80% in Japan. Citing a separate 1998 study, Scott (23) finds that ten Indonesian families control a staggering 58% of the total market cap.
19. Black & Kraakman, 1996, 1911, 1914, 1925, 1929, 1938; Coffee, 1999, 679 (functional convergence among the world's companies will and should dominate a formal convergence); *ibid.* 705.
20. *See* Blair, 1999, 19. More than 1,000 respondents to a Political and Economic Risk Consultancy survey rated Indonesia's the worst legal system in Asia. On a scale of 1 (best) to 10 (worst), Indonesia scored 9.38, compared to 9.33 for China (the next worst), 7.43 for Malaysia, 5.00 for the U.S., 4.50 for Australia, 3.0 for Japan, and 2.57 for Singapore (the best). Corruption and a creditors' inability to realize the collateral of defaulting debtors were the Indonesian problems most often mentioned. 'Indonesian Legal…', 2000.
21. *The Economist* ('Good Heavens…', 2000) puts 'corporate governance' simply: 'a fancy term for the rules used to align managers' interests with those of all shareholders.' But it is by means clear which 'sanctions' arise when the 'rules' are breached, and whether incentives should favor other stakeholders as well. {{ It clearly involves an indirect democracy—actions by commissioners and directors, elected to pursue shareholder interests—and direct democracy—shareholder referenda on particular company actions, some by super-quorum and super-majority voting: Black and Kraakman, 1996, 1943. But the purposes and effects of an 'economic democracy' have long been the subject of political dispute in Indonesia. }} Also, Bergloff and von Thadden (1999) argue that protection of creditors—a particular weakness in Indonesia, *supra*--is more important than shareholder protections in transition economies. The 'standard explanations' of poor corporate governance are low transparency, lack of effective adjudication and

enforcement of judgements, and an absence of a culture of trust (which extends beyond the family). Good corporate governance results in 'maximizing the residuals', and in pro rata distributions among the participants. Fox & Heller, 1999, 2. These are particular problems in East Asia, given a concentrated family ownership, and the resource misallocations and perverse incentives caused by the participants' anticipation of bailouts--by governments and international donors: Scott, 1999, i, 2.
A better, broader definition of corporate governance is Scott's (1999, 2): every force bearing on enterprise decision-making, including regulations and commitments to employees. {{ This is usefully glossed by Blair (1999, 2): legal rules, institutional arrangements, and practices that determine who gets what. Downplaying the economic factors I mentioned *supra*, Blair attributes governance problems to the fact that companies are fictional entities, separate from the personal responsibility and liability of participants. }} In the Indonesian context, Muhammed (2000) notes that poor corporate governance correlates with the depth of the economic crisis in a particular Asian country. Anwar (2000) defines good corporate governance in terms of developing benchmarks for the transparency, fairness, responsibility, and accountability that are essential to success in the global economy. Hardjapamekas (2000) adds a list of Indonesian needs: enforcement of a code of ethics; independent boards with enhanced skills and resources; improved business/community consultations; improved strategic planning, risk management, and procurement controls; and better management reporting and board monitoring.

22. Anwar, 2000. *See* Blair, 1999, 8; Fox & Heller, 1999, 2-5, 39-41; *ibid.* at 42 (the frequent lack of time to develop a good business reputation, where people have no ongoing course of dealings, promised behavior may run counter to established cultural norms, and there is a scarcity of reliable audits or other means of an *ex post* verification); {{ *ibid.* 52 (in Russia, and I would add Indonesia, 'loosely constrained and poorly incentivized managers are causing social welfare losses'); Secretariat, 1997, s. 1; Scott, 1999, 37 (education and training are needed because legal transplants are insufficient); 'Doing Well', 71-72; *ibid.* 72 (companies usually try to sum up their philosophy in a code). }} Hardjapamekas (2000) is President Director of a State-owned enterprise, PT Timah. It has adopted principles—solidarity, openness, and integrity—and new work attitudes: trust, openness, positive thinking, rationality, and cost consciousness. A comparison of National Committee, 1999, with Secretariat, 1997, shows that the Indonesians are much further along than are the Dutch--in spelling out corporate governance.
23. Anwar, 2000; Brietzke & Timberg, 1999, 26-27. *See* Secretariat, 1997, s. 6. Under pressure from the Defense Department, 60 U.S. defense contractors set up guidelines and compliance programs. U.S. Federal Sentencing Guidelines allow judges to reduce fines paid by companies that have meaningful ethical behavior programs, and to increase fines for those which do not. In a 'CNN world', local campaigners can beam evidence of misbehavior to a company's customers and stockholders around the world. 'Doing Well…', 2000, 71. Backed by France's Association for the Defence of Minority Shareholders, disgruntled Groupe Andre shareholders won several seats on the board. Denied a list of shareholders, they got most of the names by running newspaper ads. 'Good Heavens…', 2000. Similar arrangements could be adopted in Indonesia, where Government procurement reforms are projected (again).

24. *See* Code (Draft 3.1) Prin. 1.4n., 2.5, 3.5, 4.3, 5.5, 7.1-7.5, 8.1, 9.1 (MS in author's possession). Prin. 2.5 does not describe what Commissioners, Directors, auditors and/or other stakeholders should do, if reliable information cannot be obtained quickly. Also, maintaining the confidentiality of price information (Prin. 7.5) is a dubious recommendation, and the 'warning announcement' process can facilitate a price fixing which is prohibited by the Competition Law, No. 5 of 1999.
25. *See* Blair, 1999, 12, 21. More sophisticated techniques can also be used: Economic Value Added as a measure of shareholder value, for example. ('Good Heavens…, 2000). Recent changes in South Korea, another economic crisis-plagued country, are instructive for Indonesia: more careful audits, more carefully studied; audits which disentangle personal and conglomerate/subsidiary assets; better reporting of trade-finance liabilities; enhanced criminal penalties for accounting fraud; and an end to the 'culture of impunity' surrounding accounting failures. 'The Open Society', 2000.
26. Bergloff & von Thadden, 1999. In Europe and Asia, the stakeholder approach gives companies more of a 'team' and quasi-public character and role. This facilitates State-owned enterprises and the imposition of 'social' regulations. {{ Hostile takeovers are thus opposed because they force managers to cut staff, close plants, etc., and a greater stability ensues because investors cannot move capital as quickly--in pursuit of higher returns. }} Blair, 1999, 4-6, 21, 24; Coffee, 1999, 668-69; Secretariat, s. 1. *See* Bergloff & von Thadden (taken to extremes, a stakeholder approach disenfranchises shareholders); Coffee, 1999, 651 (jurisdictions that 'seek to promote the interests of nonshareholder constituencies…have also sought to prevent attempts to contract around…these norms'—*supra*) {{; Hardjapamekas (2000) (in Indonesia, companies must respond to community development issues); Fox & Heller, 1999, 34 (while management, employees, and local government are frequently unable to cooperate to maximize a joint benefit, companies frequently engage in 'sweetheart deals', hire unnecessary employees, and perform uncompensated public services); Secretariat, s. 5 (reducing hostile takeovers may justify restrictions on influence being proportionate to capital contributions [!]); *ibid.* s.6 (the risk is that shareholders present at the General Meeting will have a disproportionate influence, compared to those who are absent [!]) }}.
27. REDECON (1998) documents how a small construction company had to obtain 11 licenses, and how obtaining the main license for Jakarta took 13 months and cost U.S. $1485—plus $3057 in bribes. The corresponding figures for Bandung are 7.5 months, $1171, and $2071; other locations and types of business differed slightly. Many such sector- and situation-specific regulations can be safely eliminated: they generate corruption and protect a rent-seeking by elites rather than the public interest.

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